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March 12, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Via e-mail (regs.comments@federalreserve.gov)

Re: Docket No. R-1176

Dear Ms. Johnson:

JPMorgan Chase Bank ("Chase") commends the efforts of the Board of Governors of the Federal Reserve System (the "Board") on the Check Clearing for 21st Century Act (the "Act") and in marshalling industry support for that proposal. Chase appreciated the opportunity to work with the Board during the drafting process and welcomes the opportunity to provide comments in response to the related proposed amendments to Regulation CC and the Official Staff Commentary (the "Proposal") that would implement the Act. Chase is eager to work with the Board on creating balanced rules that will facilitate the electronic presentment of checks ("ECP") while protecting consumers and minimizing burdens on financial institutions. This is a key step toward the industry's goal of full ECP.

At the same time, the Proposal does raise certain concerns. Those concerns are detailed in comment letters submitted by The Clearing House and the Electronic Check Clearing House Organization, each of which Chase also supports. Chase has also signed the comment letter submitted by forty-one financial services industry firms and organizations including, among others, the American Bankers Association, dated March 11, 2004 (the "Commenters"). In this letter, we, therefore, highlight only a few major issues for the Board's consideration.

Legal Equivalency of Substitute Checks

The Act creates a new instrument called a "substitute check." To further the intent of the Act, it is critical that the validity and integrity of substitute checks be enhanced and encouraged. Certain elements of the Proposal may, however, seriously undermine that important goal. For example, Section 229.2(zz) of the Proposal permits changes only to the amount field and position 44 on the MICR line on a substitute check. Other changes on the MICR line would result in a substitute check's forfeiting its status as the legal equivalent of the original check. Limiting the permitted variations in the MICR line to these two fields is far too restrictive. If a reconverting bank identifies errors or defects in other fields on the MICR line when creating the substitute check, the reconverting bank should be permitted to correct the error for the benefit of the overall check collection process.

This flexibility is important because the recipient of the substitute check will reasonably expect that the check is the legal equivalent of the original and will expect to be able to rely on that legal equivalency. If not, the effectiveness of any substitute check will be in question. The ability to rely on legal equivalency is critical because the recipient will have absolutely no way to detect whether the MICR line on the substitute check it receives is different from the MICR line contained on the original check. Similarly, if a paying bank receives a substitute check that is not, in fact, the legal equivalent of the original because other changes have been made, a question will arise regarding the paying bank's authority to debit its customer's account to pay the item. Those questions would clearly give rise to disputes that will create a disincentive for banks to create substitute checks.

The Proposal must, therefore, encourage improvements to substitute checks, if necessary, and the industry must be encouraged to do full MICR line repairs, whenever possible, without calling into question the legal equivalency standard, permitting substitute checks to be handled in the same manner as original checks. This ability to repair the MICR line should extend to a detected misread of a MICR line to the same extent as if the MICR ink were defective causing a reader sorter to reject an item. On a related point, a bank's erroneous application of the MICR line and its failure to correct MICR read errors when it creates a substitute check also should not affect the legal equivalency of the substitute check.

Because legal equivalency is critical, we also completely disagree with the Proposal's creation of a new item, the "Purported Substitute Check," in section 229.51(c). The Act does not provide for a "purported substitute check." Section 229.51(c) states that if an item meets all of the requirements of a substitute check except for the MICR line requirement in section 229.2(zz)(2), the item is a substitute check but it is not the legal equivalent of the original check. Creation of such an item only serves to create confusion and uncertainty. A reconverting bank would have no incentive to make a correction to

the MICR line and assume any warranties or indemnities if it were unable to transfer the legal equivalent of the original check. This disincentive clearly frustrates the intent of the Act and is contrary to the manner in which checks are repaired and processed today. Banks must be willing and able to create and process substitute checks (including MICR line repair) exactly as if they were processing original checks. In this regard, the Proposal actually has the undesired effect of taking a major step backward.

Indorsements and General Substitute Check Specifications

Appendix D of the Proposal contains precise specifications for the placement of an indorsement on a substitute check. Because a substitute check is a new instrument with which banks have no experience, the Board should not incorporate such precise specifications into Regulation. When Regulation CC was first promulgated, it merely accommodated long-standing industry practice by codifying and refining the long-standing indorsement practices of the industry. Because substitute checks are new instruments, no such long-standing practice exists. It is, therefore, important to anticipate some evolution in the creation and processing of substitute checks by allowing for flexibility in these requirements. To that end, we suggest that the Board acknowledge the general industry standards as issued by the Accredited Standards Committee ("ASC X9") as the accepted industry standard without adding further detailed specifications.

Likewise, the Board should defer to the generally applicable industry standards with respect to the general specifications of a substitute check, that are being developed by ASC X9. Realizing that there is a need for consistency, the Board should make a reference to these specific standards in the Official Commentary and acknowledge that following these standards would constitute compliance with the Act. The regulation of substitute checks must be a fluid process that can easily accommodate change in the event of subsequent developments in industry standards. The Board should structure its guidance so that changes could easily be made to the Official Commentary rather than requiring the more cumbersome amendment of Regulation CC.

Paying Bank Creating Substitute Checks Without MICR

The Proposal states that a substitute check that has all of the elements of a substitute check, except the presence of MICR ink, is not the legal equivalent of the original check. We view this standard as unduly restrictive. Specifically, we strongly urge the Board to authorize a substitute check created by the paying bank solely for the purpose of providing a paper check to its consumer customer (and for no further processing purposes) to be the legal equivalent of the original check. This is important because, for example, New York State Banking Law section 9-m requires a bank to offer consumers the option of having a checking account that returns the paid check with the account statement. The Commonwealth of Massachusetts has a similar statute. A substitute

check that is the legal equivalent of the original would facilitate compliance with that statute in an ECP environment. If, however, the paying bank were required to create the substitute check with MICR ink, there would be an incremental cost to the bank without any resulting benefit to the consumer. Consumers do not have the need to receive paid items bearing MICR ink. In fact, it is unlikely that a consumer would know the difference between an item that does or does not bear MICR ink. In this context, the absence of MICR ink will not in any way compromise the other attributes of the substitute check. In this limited instance, the non-MICR ink substitute check would still carry the warranties, indemnities and expedited re-credit rights otherwise associated with a substitute check.

We recognize and share the Board's concern that the regulation must not permit other types of imaged copies of checks to be deemed substitute checks and entitled to the warranties, indemnities and expedited re-credit rights of substitute checks. However, limiting the exception to the MICR ink requirement to the specific circumstances described herein would preclude the expansion of the definition of substitute checks to other types of imaged copies of checks.

We also note that our concerns are not limited to firms operating in New York and Massachusetts. Although banks in other jurisdictions may not have a statutory compliance requirement, they may, nevertheless, wish to provide customers with a legally equivalent document as a matter of good customer service.

Consumer Awareness Notice

We support Alternative #2 contained in section 229.57(2) but suggest the notice be permitted to be given not only at the time of delivery of the substitute check but also at any time up to the delivery of the substitute check. A requirement that the notice be given at the time of the request for a copy of the check by the consumer is inappropriate because, at the time of the request, a bank may not know if it will, in fact, provide a substitute check.

We also support the safe harbor for a bank using the model notice contained in Appendix C-5A. However, the model notice is unnecessarily lengthy and exhaustive and has the potential, given its excessive detail, to create confusion for consumers. We urge that the model notice be shortened and contain only a simple definition of a substitute check, an explanation of how the substitute check can be used, a simple statement of the expedited re-credit rights for substitute checks and a telephone number or a website address that can be accessed for more detailed information. We, therefore, call to your attention and concur with the suggested model notice contained in the letter submitted by the Commenters.

Remotely Created Demand Drafts

Although not part of the Proposal, the Board has requested comment relating to "remotely created consumer items." The Proposal makes reference to Uniform Commercial Code (the "UCC") revisions that create a warranty by the transferor of a remotely created demand draft. The transferor warrants that the person on whose account the item is drawn authorized the issuance of the item in the amount for which the item is drawn. This is logical because the depositary bank that receives the item from its customer is in the best position to determine if the item is authentic. Because the item does not bear the drawer's signature, the paying bank is unable to determine whether the item is properly payable and debit its customer's account. This recommended approach has been adopted by various states in their versions of the UCC as well as by various clearinghouse associations.

However, the Proposal needs to be more encompassing. There is no reason for this warranty to be limited to items drawn against consumer accounts. Remotely created demand drafts are also drawn against commercial accounts. Consequently, the Board should expand the warranty to cover all remotely created demand drafts. In addition, the warranty should be expanded to cover all elements of the item and should not be limited to the amount of the draft.

We recommend that the Board consider this warranty under a separate amendment to Regulation CC with its own proposal and comment period. This amendment is not critical to, and should not be part of, the Check 21 regulation process.

Check 21 and ACH Debits

The Board has requested comment on whether using information from a check to create an ACH debit entry should be a payment request covered by the warranties under the Act. We believe that the Act's warranties should not apply to this type of a transaction. This transaction is outside the scope of the Act and is covered by Regulation E and the ACH rules which adequately protect the interests of the consumer in the event of a claim of an unauthorized debit to the consumer's account. In addition, the ACH rules already set forth the rights and liabilities of the respective financial institutions.

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We thank you for the opportunity to present these comments and encourage the Board staff to contact us with any questions they may have.

Sincerely,

Lloyd G. Harris